No. 6535

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

RENFRO-WADENSTEIN, a corporation, and RENFRO-WADENSTEIN FURNITURE COMPANY, a corporation, KETCHAM & ROTHSCHILD, INC., a corporation,
Cross Appellant,

—VS.—

WALTER S. OSBORN, as Trustee in Bankruptcy for Renfro-Wadenstein, a corporation, and Renfro-Wadenstein Furniture Company, a corporation, Bankrupts,
Cross Appellee,

and

ROBERT W. IRWIN COMPANY,
Cross Appellant,

—VS.—

WALTER S. OSBORN, as Trustee in Bankruptcy for Renfro-Wadenstein, a corporation, and Renfro-Wadenstein Furniture Company, a corporation, Bankrupts,
Cross Appellee.

UPON CROSS APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

REPLY BRIEF OF TRUSTEE ON CROSS APPEAL

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STATEMENT OF THE CASE

The trustee subscribes to the statement contained in cross-appellants' brief to Page 14 thereof inclusive, except the conclusion drawn on Page 7 as to the date of execution of the contract and except the reference on Pages 10 and 11 to a *modification* of the contract by a letter under date of March 23. Beginning with Page 15, the statement partakes of the nature of argument and accordingly, we take exception to the remainder thereof. There is no disagreement as to the amounts of merchandise or accounts receivable or proceeds involved in the action since the sums enumerated in cross appellants' brief correspond with the findings of the referee (Tr. 93-96 incl.). These figures were likewise employed by the District Court in its decision (Tr. 230-231). In this regard, we except only to the inference on Page 73 of cross-appellants' brief to the effect that there was turned over to the trustee a fund in excess of $5,321.22, resulting from sales of consigned merchandise. While the receiver turned over such sum to the trustee, that sum comprised the amount that Hills as assignee turned over to the receiver, together with additional collections made by Hills up to the time of the election of the trustee.

> "None of these additional collections involved furniture here in dispute." (Tr. 75)

BRIEF OF ARGUMENT

I

As against the trustee, there was no valid transfer from Renfro-Wadenstein to Ketcham & Rothschild of merchandise shipped prior to April 1, 1928.

(a) Bill of sale was not recorded within ten days after sale, and is therefore invalid.

1. Sale was consummated March 23, 1928.

2. The letter of March 23 does not affect the contract.

3. Contract was accepted by Ketcham & Rothschild more than ten days prior to recordation of bill of sale.

(b) The merchandise was left in the possession of dealer.

II

As against the trustee, there was no valid transfer from Renfro-Wadenstein to Irwin & Company.

(a) Irwin's bill of sale was never recorded.

(b) The merchandise was left in the possession of dealer.

III

The transfers would in any event be a preference.

(a) Trustee is in position of creditor and is entitled to benefits of state law.

(b) Dealer was insolvent at the time of the transfer.

(c) Insolvent corporation may not prefer its creditors.

(d) No present consideration was given dealer.

IV

Accounts and proceeds may not be reclaimed.

(a) They do not constitute a trust fund.

(b) The fund was not traced.

ARGUMENT

At the outset, the cross appeals herein are immaterial if the court finds that the contracts were not valid consignments, for cross appellants' right of reclamation is predicated solely upon the consignment agreements. Consequently, a discussion on the cross appeals is pertinent only if the court should find that the so-called consignment contracts are in fact consignments.

I

There was no valid transfer from dealer to Ketcham & Rothschild of merchandise shipped prior to April 1, 1928.

Section 5827, Remington's Compiled Statutes is as follows:

> "No bill of sale for the transfer of personal property shall be valid, as against *existing*

creditors or innocent purchasers, where the property is left in the possession of the vendor, unless the bill of sale be recorded in the auditor's office of the county in which the property is situated, within ten days *after such sale is made.*" (Italics supplied)

The so-called consignment agreement, paragraph 9 thereof, provided:

"Said party of the second part has in its possession certain goods, as per attached list, which have heretofore been sold and delivered to him by said party of the first part on credit, and which have not been paid for, *and it is hereby agreed that the title to said goods, and the same is hereby transferred and conveyed back to said party of the first part, and that from and after this date same shall be treated as having been delivered to said party of the second part on consignment and under and subject to all of the terms and conditions of this contract.* In consideration of the transfer and conveyance of the title to said goods back to said party of the first part, that company does hereby cancel the indebtedness of said party of the second part for said goods." (Tr. 115, 116, Tr. 147)

"* * * The statute which provides that no bill of sale of personal property shall be valid as against existing creditors, where the property is left in the possession of the vendor, unless the

bill of sale is recorded in the auditor's office of the county in which the property is situated within ten days, does not say within ten days after the bill of sale is delivered, but '*within ten days after such sale shall be made.*' Unquestionably, the sale of the automobile in this case was made, and written proof of it executed and delivered by Mr. Meyer to the appellant on October 2, 1919. The second bill of sale, claimed to have been delivered about October 17 or 18, and which was executed and acknowledged on October 2, was ineffectual to prevent the running of the ten-day period after the sale was made as provided in the statute."

Schloss v. Stringer 113 Wash. 529, 532, 533; 194 Pac. 577.

Thus, the ten-day period begins to run from the date on which the sale was actually consummated, irrespective of whether some subsequent bill of sale is executed. It is undisputed that Renfro-Wadentsein executed the above contract on March 23, 1928 (Tr. 20). It is also true that Rothschild received manual delivery of the contract on March 23 (Tr. 20). Ketcham & Rothschild signed the contract March 30, 1928 (Tr. 20). It is to be remembered that cross appellants drafted the contract (Tr. 4). It is not disputed that the terms of the consignment contract contemplated a sale back by the bankrupt to both petitioners of merchandise of petitioners theretofore held by

bankrupt (See Petitioners' brief, page 10). Paragraph 9 of the contract is unambiguous and speaks for itself and unless it was *modified* by the letter of March 23, introduced over trustee's objection, a sale was clearly consummated on March 23 from Renfro-Wadenstein to Ketcham & Rothschild. When paragraph 9 was inserted in the contract and the consignment contract was signed, it was clearly intended to mean immediate cancellation of the said indebtedness, and at that time it was thought that was to the interest of petitioners. The letter of March 23, giving bankrupt's misinterpretation of the proposed contract, was introduced as a result of an afterthought in an attempt to avoid the danger that otherwise the parties would be held to the letter of their contract, and that it would be decided that the sale was consummated on March 23, 1928. The letter was not sued upon by petitioners as a modification of the contract and Irwin, in his deposition (Exh. 55), in three different places, at pages 20, 26-27 and 65, states that the contract of consignment covered and contained the whole agreement between the parties.

Furthermore, at the time the contract was executed, Rothschild had been in Seattle for three days (Tr. 20). The property conveyed back comprised all the furniture of his manufacture on bankrupt's floor and an approximate figure was taken from the stock cards while Rothschild was in Seattle (Tr. 21, 43). There was nothing further to do except the ministerial act of

listing the furniture in detail. No segregation of the furniture was necessary in Ketcham & Rothschild's case. Wadenstein testified that the contract was signed by Ketcham & Rothschild while Rothschild was in Seattle (Tr. 39).

The fact that a detailed list of the furniture was not attached to the contract makes no difference. It is fundamental that where a contract is complete except as to mere formality, the date of the contract is from the time of its completion as to the essentials and it does not date from the time of the completion of the formality. This is so even where the contract makes express mention of the formalities which are to be completed. In *Granger & Co. v. Louisville Cornice, Roofing & Heating Co.*, 116 S. W. 753, a bid was made for a contracting job and was accepted as follows:

> "Accepted in conformity with contract to be made hereafter."

The court said that the latter words:

> "Did not make his acceptance merely conditional. All that was contemplated by that language was that a formal contract should be drawn between the parties. That this construction of the language is correct is shown by their subsequent conduct. The contract of March 3, which plaintiff claims was not signed until March 26, simply embodied in a formal and legal way the provisions of the proposition theretofore ac-

> cepted. This contract did not add to nor subtract from plaintiff's liability on its proposition of January 5. By that proposition it was already bound."

Similarly, in *Sellers v. Greer* (Ill.) 50 N. E. 246, S. and G. were in business together. The business did not progress satisfactorily and S. offered to purchase G's share. That proposition was put in writing in which the details of the proposed purchase were enumerated, and the agreement was headed "Outline of Proposition between Howard Greer and Morris Sellers." At the end of this writing there was the following statement:

> "This agreement to be put in proper form at as early a date as possible pending the return of the company's attorney to draw up the necessary releases, etc."

The writing was then signed "Morris Sellers, Tuesday, September 4, 1894." The court stated:

> "It will be observed that appellee did not sign the contract, and hence it is contended that the contract is not mutual. It appears, however, that the contract was delivered by Morris Sellers, appellant, to appellee on the day it was executed, and that appellee accepted the contract and agreed to its terms and conditions. The acceptance of the contract by appellee assenting to its terms, holding it, and acting upon it as a valid instrument, may be regarded as equivalent

to its formal execution on his part, as held by this court in *John v. Dodge*, 17 Ill. 442, and *Vogel v. Pekoc* (Ill.) 42 N. E. 386."

To the same effect are:

Harland v. Logansport, 32 N. E. 930;
McPherson et al. v. Fargo (S. D.) 74 N. W. 1057;
Johnston v. Trippe, 33 Fed. 530.

Upon acceptance of the contract on March 23rd, Ketcham & Rothschild could have enforced the same against Renfro-Wadenstein.

Vassault v. Edwards, 43 Calif. 465.

In any event, Ketcham & Rothschild signed the contract March 30, at the latest (Tr. 20), and immediately shipped merchandise under the consignment arrangement (Tr. 22). The testimony is conclusive from Wadenstein that the debtor treated the furniture attempted to be conveyed back from the date of the consignment agreement as consigned furniture (Tr. 49). The furniture was therefore intended by the parties to be the property of Ketcham & Rothschild from that date. Ketcham & Rothschild treated the contract in that light for they made shipments of furniture long prior to delivery of the bill of sale dated April 16 (Exh. 9, Tr. 30). The shipments referred to from Ketcham & Rothschild are represented by the invoices of April 2 and April 7 (part of petitioners' Exh. 3) and demonstrate that Ketcham &

Rothschild treated the consignment agreement as fully effected in all respects March 30, 1928, and operating on the furniture conveyed back as well as furniture subsequently shipped. See *Hosner v. McDonnell*, 114 Wash. 489, 195 Pac. 231; *Phillips v. Moore*, 71 Me. 78. Even assuming that the parties were under the eroneous belief that it was advisable later to execute another bill of sale, such is wholly immaterial in determining the end of the ten day period for recordation.

Schloss v. Stringer, 113 Wash. 529, *supra.*

Ketcham & Rothschild are in the unique position of claiming where it suits their purposes that the consignment agreement became effective March 30, 1928, and at the same time taking the position that as to such portions thereof that now appear burdensome to them it did not take effect until some time later. The great bulk of the Ketcham & Rothschild shipments under the so-called consignment arrangement was made on April 2 and April 7. If the consignment contracts were then in effect, certainly a sale had been made either on March 23 or March 30 unless the letter of March 23 *modified* the contract. It is of course admitted that the Ketcham & Rothschild bill of sale was not recorded until April 24, 1928 (Tr. 139).

So far as Ketcham & Rothschild's cross appeal is concerned it is rested upon the letter of March 23. That letter reads as follows:

"Referring to the attached memorandum of agreement:

"*It is our understanding* that we are to furnish, shortly after the first of the month, an inventory of all your merchandise on hand; that we also are to furnish bill of sale which will act as a transfer back to your company of this merchandise, and that any difference in the amount of the account will be taken care of in three equal payments, thirty, sixty and ninety days.

"This refers in particular to paragraph No. 9." (Italics supplied)

The letter is signed by Renfro-Wadenstein, but is not signed by Ketcham & Rothschild (Exh. 26, I. D.; Exh. 1). Cross appellant complains that the District Court failed to consider this letter. Such is not the case. The District Court stated:

"After the execution of the agreement the relation of the parties and the merchandise was established, and neither had the right to change or give to the agreement its own interpretation." Citing authorities. (Tr. 235)

It is obvious in conjunction with this letter, first, that it is merely an expression of the understanding of one party to the contract ("it is our understanding"); second, that it does not express a contractual relationship; and third, that it does not modify paragraph No. 9 of the contract.

"After a contract was made between defend-

ant and the individual contestants, including the plaintiff, the defendant could not change the rights of the contestants thereunder through its misinterpretation of the rules as published, nor did it have the right to change or give to the rules its own interpretation." *Mooney v. Daily News Co.* (Minn.) 133 N. W. 573.

In *Sturtevant Co. v. Cumberland, D. & Co.*, 68 Atl. 351, there was a contract of consignment made by letters in which no mention was made as to insurance by the consignee. On the invoices sent by consignor there were statements requiring the consignee to insure. The court stated:

"When a contract has been entered into between two parties, neither party alone has the right to add to it new terms or conditions. Such attempts are nullities and carry with them no legal obligation to be respected or obeyed by the other party; for if the consignor can add one, he can add a dozen." Page 355.

See also:

Newhall Land & Farming Co. v. Hogue, Kellogg Co., 204 Pac. 562.

Thus it is apparent that an agreement would be necessary between the two parties. It is claimed that the letter was written at the oral request of Ketcham & Rothschild, but the letter is not signed by them and is therefore not a written agreement between the

parties. Cross appellants are not suing on an oral contract, but upon the written agreements. Furthermore Section 5827 Remington Compiled Statutes, *supra*, constitutes a portion of the statute of frauds. An oral agreement cannot modify a writing under the statute of frauds.

Woolen v. Sloan, 94 Wash. 551, 553;
Coleman v. St. Paul & D. Lbr. Co., 110 Wash. 259;
Abell v. Monson, 18 Mich. 306.

It is elementary that where a written contract is unambiguous in its terms, parol evidence of the intention of the parties plays no part in determining the effect of the contract. No reference is made in the instant contract to the letter of March 23. The contracts are signed, dated and unambiguous as to sale. The letter of March 23 is at best merely a statement of the understanding of one party thereto as to the agreement between the parties. It makes no attempt to *modify* paragraph 9. Furthermore, if the principal contract was not complete until March 30, the letter was merged therein and became merely a part of the negotiations between the parties. The statement that the bill of sale "will act as a transfer back to your company" is emphasized by petitioner. Under the decision in *Schloss v. Stringer*, *supra*, this provision, even if a part of the contract, would merely contemplate a carrying out of paragraph 9 as to formality and would not prevent the ten day period from run-

ning from March 23 when the sale was actually consummated.

Furthermore, Rothschild testified that the consignment contract was signed without any modification, without any reservation (Tr. 279). The letter of March 23 was introduced over the trustee's objection, the original transcript of the testimony being included in this record (Tr. 274-279 incl.). It will be observed from the original transcript of testimony that Rothschild had the opportunity, not only to make the letter a complete contract, but also clearly to indicate that it modified Paragraph 9 (Tr. 277). Nevertheless, the letter merely bears an indication of the dealer's interpretation of the contract.

As to the Ketcham & Rothschild contract, therefore, the sale was completed March 23 or at the latest on March 30. Ketcham & Rothschild definitely accepted the contract on March 23, again on March 30 and again on April 2 and April 7. Recordation of the bill of sale was April 24. The letter was no modification of the contract and the subsequent execution of the bill of sale does not cure the defects of failure to record within the ten day period.

The merchandise never left the possession of dealer (Tr. 52). See *infra* under Irwin Contract.

II.

As against the trustee, the transfer from dealer to Irwin & Company was invalid.

The Irwin bill of sale was not recorded (Tr. 6. Cross appellants' brief, p. 68). The only contention on behalf of Irwin is that there was sufficient change of possession of the furniture to avoid the provisions of Section 5827, Remington's Compiled Statutes, *supra*. Yet the only basis for this contention is a change of relationship alleged to have taken place between the parties. Assuming this change of relationship did take place, which the trustee emphatically denies, the only evidence thereof were the secret consignment contracts and bookkeeping entries subsequently made. There was no indication given to the public that there had been a transfer of title. There was no separation of the furniture on the dealer's floor (Tr. 17, 33, 34). Utmost secrecy was attempted in connection with the consignment (Tr. 30, 31). Mere bookkeeping entries are not sufficient notice to the outside world. The provision of the statute is perfectly plain. A transfer of personal property is wholly ineffectual as against existing creditors unless there is a sufficient change of possession to notify the world, or there is constructive notice by recording. We do not claim that manual delivery is necessary to effect a change of possession with articles like those involved here, but we do insist the change must be of

such a character that notice of change of ownership is conveyed to the world. Cross appellants' rely upon the *Haskin's* case and the *Speicker* case (Page 69). In the *Haskin's case*, 93 Wash. 63, 66, an agent of the defendant bank went to the mill and was authorized to take possession of the lumber, then in the yard, to sell the same, and credit the amount received upon the note. The agent checked the lumber, employed someone to haul the lumber away. Snow prevented the hauling, except of a small portion of the lumber, but there was manual delivery of at least a portion and there was consequent notice to the outside world of the change of possession.

In the *Speicker* case, 134 Wash. 280, *actual possession* was taken of a farm together with the chattels thereon (Page 285). A more recent case is *Waddell v. Roberts*, 139 Wash. 273, 276, 279; 246 Pac. 755. This case sustains the trustee's position. In *Hyman v. Semmes* (C. C. A. 6th) 26 Fed. 2nd 10, an unrecorded bill of sale was involved.

> " * * * Possession of the lumber having been surrendered and (there being) finding that the cards or notices were merely affixed to the lumber 'in an indefinite and irregular manner, apparently without any effort to maintain the notices upon the lumber or to notify third parties of the ownership of the same,' we are constrained to hold that such notices would not make effective an agreement or contract expressly declared null and

void as to existing and subsequent creditors by the statutes of Tennessee."

See also Pages 32-37 inclusive, Trustee's opening brief.

III

The attempted transfer of title would be a preference.

The trustee is in the position of a creditor and is entitled to the benefits of the state law in the same manner as any existing creditor. The District Court stated otherwise (Tr. 232), but failed to cite a single authority in support of its conclusion. The District Court's conclusion failed to take into account the distinction between the right of a party to avail himself of the bankruptcy act and the subsequent right of the trustee of the bankrupt's estate in administering the same.

"Section 70e of the Bankruptcy Act provides: 'The trustee may avoid any transfer by the bankrupt of his property *which any creditor of such bankrupt might have avoided*, and may recover the property so transferred or its value from the person to whom it was transferred unless he was a bona fide holder for value prior to the date of the adjudication. Such property may be recovered or its value collected from whoever may have received it, except a bona fide holder for value. For the purpose of such recovery, any

court of bankruptcy as hereinbefore defined, and any state court which would have had jurisdiction if bankruptcy had not intervened, shall have concurrent jurisdiction.'

"This section, as construed by this court, gives the trustee in bankruptcy a right of action to recover property transferred in violation of state law. *Security Warehousing Co. v. Hand,* 206 U. S. 415, 425, 426; 51 L. E. 1117, 1124; 27 Sup. Ct. Reports 720; 11 Ann. Cas. 789; *Knapp v. Milwaukee Trust Co.,* 216 U. S. 545; 548; 54 L. E. 610, 611; 30 Sup. Ct. Rep. 412.

"And a right of action under this subdivision is not subject to the four months' limitation of other sections (60b, 67e) of the bankruptcy act. Under this subdivision if a creditor could have avoided a transfer under a state law, a trustee may do the same. *Re Mullen,* 101 Fed. 413 (Opinion by Judge Lowell); 1 Loveland, Bankr. 4th Ed. 786, 787; *Collier, Bankr.,* 11th Ed. 1178, and cases cited in Note 439."

Stellwagen v. Clum, 62 Law. Ed. 507, 511; 245 U. S. 605, 606, 614.

"And certainly, in view of the provisions of Section 70e of the bankruptcy act, Congress did not intend to permit a conveyance such as is here involved to stand which creditors might attack and avoid under the state law for the benefit

of general creditors of the estate." L. E. 513; U. S. 618.

The *Stellwagen* case was approved in *Stratton v. New*, 75 L. E. 617, 623 (1930). This court has definitely committed itself to the above effect.

Davis v. Willey (C. C. A. 9th) 273 Fed. 397.

See also:

Williamson v. Leith et al. (C. C. A. 5th) 36 Fed. 2nd 643, 645.

Cross-appellants' cases (Page 62) fail to support their contention. *U. S. v. State of Okla.*, 67 L. E. 638, was an action under a federal statute which statute made the federal bankruptcy act the test of insolvency for the purpose of enforcement of rights under that statute. In the *Chappell* and *Walker* cases, no question was raised as to a state statute. The *McGill* case, 243 Fed. 637, definitely sustained the trustee's position and held that the trustee was entitled to recover as well under the New York statute as under the bankruptcy law (Pages 650-653).

A case similar in circumstance to the instant cases was that of *J. R. McCrory*, trading as J. R. McCrory Company, bankrupt (U. S. D. C., Pa.) 11 Amer. Bankr. Rep. N. S. 437, in which chains had been sold to bankrupt and bankrupt could not pay for same. Bankrupt had sold to customers a portion of the chains. It was agreed that the remaining portions should be held on consignment. The court stated:

"At the time such agreement was entered into, no change of position occurred, nor by marking or otherwise was notice given to creditors that the chains in question were not the property of the bankrupt. Under Section 47 of the bankruptcy act, the trustee in bankruptcy, as to all property in the custody or coming into the custody of the bankruptcy court, is deemed to be vested with all the rights of the creditor holding a lien by legal proceedings. By the law of Pennsylvania, a transfer of property such as was made in the instant case is fraud as against creditors."

See also:

Joseph v. Winakur, 13 Amer. Bankr. Rep. N. S. 259;

In re Franklin Lumber Co., 187 Fed. 281, 283;

In re Carpenter, 125 Fed. 831, 835.

INSOLVENCY

Bankrupt with the knowledge of claimant was insolvent March 23, 1928, and thereafter. The referee's finding to this effect (Tr. 88, 89, 101) is well supported by the evidence. Upon the testimony of Wadenstein and the deposition of Irwin, it is demonstrated beyond successful contradiction that at that period the bankrupt was, and for a considerable time prior thereto, had been over-expanded, under-capitalized and unable to pay its debts in the ordinary course as

they matured (I. D. 59, 68, 69; Tr. 40, 46, 47). The condition in which the two claimants found themselves in March was one into which they had gradually become involved until it was sufficiently acute to require drastic action on their part. They both knew at that time and later that bankrupt was hypothecating its accounts with discount companies (I. D. 54, 56, 63, 69, 87. See discussion of insolvency in trustee's opening brief Pages 42, 43, 44 and references to transcript made therein. See also I. D. 3, 4, 5, 57, 58, 59 and Exhs. attached to I. D. 4, 14, 16, 19, 24 and Exh. 45, several parts, 46, 47). There was also introduced in evidence a letter from another manufacturer creditor expressing impatience at being unable to collect anything on his account (Trustee's Exh. "F"). And Wadenstein admits that the inability of his firm above referred to was not confined to these two claimants, but extended to the firm's creditors generally (Tr. 40, 43, 44). Wadenstein had been exceedingly optimistic and enthusiastic, but

> "There was no question that we were operating with too little capital * * *. As far as paying all of our bills in the course of our business, I don't think there was a time in the history of our business, when we could have done that. *There was not a time in the history when we could pay all our bills and stay in business.*" (Wadenstein, Tr. 46; see also Tr. 47)

"A corporation which cannot pay its debts in the ordinary course of business is insolvent, even though the reasonable value of its assets may exceed the amount of its liabilities." *Brooks v. Parsons Co.*, 124 Wash. 300, 303; 214 Pac. 6; see also authorities to the same effect cited Page 45 of trustee's opening brief.

It is equally elementary that an insolvent corporation may not prefer its creditors; that its property on insolvency becomes a trust fund for the benefit of all its creditors to be equally and ratably distributed among them.

Thompson v. Huron Lbr. Co., 4 Wash. 600, 30 Pac. 741, 31 Pac. 25;

Conover v. Hull, 10 Wash. 673, 39 Pac. 166;

Benner v. Scandinavian Amer. Bank, 73 Wash. 488, 131 Pac. 1149;

Jones v. Hoquiam Lbr. & Shingle Co., 98 Wash. 172, 167 Pac. 117;

Simpson v. Western Hdwe. & Metal Co., 97 Wash. 172;

Williams v. Davidson, 104 Wash. 315, 176 Pac. 334;

Woods v. Metropolitan Natl. Bank, 126 Wash. 346, 349, 218 Pac. 266.

Cross-appellants attempt to avoid the inexorable result of the above cases by insisting that a valid present consideration was paid the dealer (Page 64). The contract itself recites that the consideration for

the conveyance of the furniture is the cancellation of the indebtedness of the dealer to the manufacturer (Tr. 147, Par. 9). No other consideration is recited, so that the consideration was not a present one but was the cancellation of an antecedent indebtedness.

Cross-appellants argue (Page 65) that the consideration was the shipment of more furniture by manufacturers to dealer. Shipment, however, was entirely at the option of the manufacturer (Tr. 113, Par. 1; Tr. 144, Par. 1). The contract could be terminated at any time and payment demanded for the merchandise (Tr. 116, Par. 10; Tr. 147, Par. 10). Consequently, manufacturers did not bind themselves to render any assistance to the dealer. Furthermore, these claimants were not the only manufacturers of high-grade furniture from whom Renfro-Wadenstein might have obtained merchandise. Other concerns had given Renfro-Wadenstein extended credit and could supply high-grade furniture (Tr. 40). The Johnson firm was an example (Trustee's Exh. F).

In addition, instead of conferring a favor upon dealer by shipment of further furniture, manufacturers in reality burdened dealer with an obligation to pay for the merchandise upon manufacturer's demand. Such was the effect of Paragraph 10 of the contract. Conveyance of the merchandise and the execution of the "consignment" contract were required, as the record amply shows, because of the fear of the manufacturers that they would not procure

payment for the merchandise. Of the cases cited by cross-appellants, the *Terhune* case is adequately distinguished by the referee (Tr. 219, 220). Of the other Washington cases cited by cross-appellant, there was in no instance an injury to other creditors or a depletion of the assets of the insolvent and in the *Lloyd* case it is stated that the theory of the trust fund doctrine is the denial of equality of advantage and in the *Hoppe* case it is stated that transactions of this character are subject to severe scrutiny by the courts. Obviously, other creditors have been denied an equality of advantage if these claimants may reclaim the merchandise shipped prior to April 1, 1928. The *Fogg* case implies first, a bona fide purchaser, and second, a valuable present consideration.

IV

Accounts and proceeds may not be reclaimed.

The accounts and proceeds were not trust property, either under the contract or under the operations of the parties. It was clearly intended that title to the furniture in any event passed whenever Renfro-Wadenstein made a sale. The billing of the invoice price at a discount of two per cent due the 20th of the following month, and the acceptance of notes and cash by claimants evidenced that debtor thereafter owned the account represented by such sale (Tr. 14, 15). Wadenstein testified:

"As our sales were reported to the claimants,

they billed us as I have testified, and on our side as we sold this merchandise, we entered that merchandise on our books in the regular course of business as soon as our bookkeeper could get to it and *it was added to our accounts receivable.* These claimants were then entered on our books as our *creditors* to the invoice amount of our merchandise we had sold. We made no distinction in the transactions I have discussed between the merchandise that was transferred back or attempted to be transferred back to claimant and the merchandise that they subsequently shipped to us; * * *." (Tr. 51)

The accounts receivable were discounted and intermingled with the general proceeds of dealer's business just as had been done before the consignment arrangement (Tr. 54, 56, 58, 59). When the furniture was sold the accounts receivable became assets of Renfro-Wadenstein (Tr. 56). These accounts could be assigned as collateral to the manufacturers by Renfro-Wadenstein (Tr. 56, 114, Par. 5; Tr. 146, Par. 5). It would have been very easy for petitioners in the consignment agreement to have forbidden the discounting of these accounts, a practice which was known by them to exist, but no protest was made thereto and we find Irwin saying in his deposition, Page 75:

"Q. In other words, after they sold their

merchandise, you made no effort to find out what they did with that money?

A. No, we had a contract with them and they were to have made settlement with us in accordance with the terms of that contract. We had a basis for *payment.*"

"The unrestricted authority which he unquestionably possessed as regards to the terms of sale to be made, very strongly tends to give the contract the character of one of sale. The stipulation that the proceeds of sale, whether in notes, cash or accounts, shall be the property of the plaintiffs and held in trust for them, can scarcely be said to militate against this view, and plaintiffs do not in any event agree to take accounts in payment or notes which are such as the contract describes. When, therefore, the contract provides that the proceeds of sales made by the plaintiffs shall be the property of the plaintiffs, it seems plain that what is contemplated is that they shall be security merely." *Adriance v. Rutherford* (Mich.) 23 N. W. 718.

The customers' accounts in practically every instance represented various pieces of furniture only a few of which were referable either to the bills of sale or to the consignment arrangement (Tr. 54, 80, 82). In the assigned accounts, there was no designation of the name of the manufacturer (Tr. 80, 82). Officers of the discount firms denied any knowledge of the

consignment arrangement (Tr. 80, 82). Cross-appellants claim that the assignments to the discount companies were invalid. The discount companies are not before this court and we are not defending them in this proceeding. However, as to them, this can be said in fairness. As Irwin put it in his deposition, petitioners were willing to go to these lengths with full realization of the debtor's weakened position financially because "he was willing to run *that hazard* for the purpose of doing the increase in business with people that are in that condition" (Irwin's Dep. 69). Both petitioners made it possible for bankrupt without objection on their part, but with full knowledge, to hypothecate these accounts and realize money therefrom with which to continue business and, to sell petitioners' furniture and augument petitioners' profits. Certainly as to these accounts and cash, petitioners are now in a poor position to claim preference and priority either at the expense of the general creditors or at the expense of the discount companies whose money in good faith was brought into the business.

> "There is another principle involved, the well established principle of equity that when one of two persons must suffer by the fault of a third, the loss shall fall upon him who has enabled such third person to do the wrong * * *. They (petitioners in this instance) could and should have taken exclusive possession of the property and not left them in possession and apparent

ownership * * *. Such laches and negligence prevents them from setting up the bill of sale."

Bonnivier v. Cole, 90 Wash. 526, 530.

Petitioners have the burden of establishing their title and ownership of the furniture on hand and their superior right to the proceeds of sale and collections therefrom, and such proceeds must be traced into the possession of the trustee in bankruptcy.

TRACING

With the exception, possibly, of a small amount of cash realized by S. T. Hills from the sale of specific furniture, petitioners have wholly failed even to attempt to trace any of these proceeds or cash into the hands of the trustee in bankruptcy. The cash received by the assignee for the benefit of creditors was approximately $300.00 (Tr. 77). The accounts which petitioners are claiming have been from time to time realized by the bankrupt through discounting, and the proceeds inextricably intermingled in their business. It is our position that petitioners cannot follow the proceeds of accounts or the accounts themselves into the hands of the trustee, unless the petitioners can trace the trust fund in kind or in specific property into which it has been converted and demonstrate that the trustee in bankruptcy has received the benefits thereof and that it had come into his hands.

In the *John Deere Plow* case, 137 Fed. 802, the agreement was held to be a consignment. It differed

in important particulars in that regard from the agreements involved herein, for the bankrupt was appointed as "their authorized agent for the sale on commission of the consigned goods." The agreements there provided also that "all proceeds of sale, whether cash or notes, shall be kept separate and distinct from second party's other business." Here we find no such provisions and yet the court refused to allow petitioners' priority over other creditors to funds in the hands of the trustee for the reason that it did not appear that any of the money received from the sale of goods actually passed into the hands of or was held by the trustee. The court stated:

> "The owner of a fund which has been misappropriated by one who held it in trust cannot follow it in the hands of the trustee unless he can trace the trust fund *in kind*, or *in specific property* into which it has been converted, or if the fund has been mingled with the trustee's other property, establish a charge on the price of such property for the amount of this fund. In other words, he can secure a preference out of the proceeds of the estate of insolvents only where he can trace the trust fund or property in its original or some substituted form in the estate which comes into the hands of the trustee."

The court said that this preference did not depend on the construction of the contract, but rather upon the rule of preference in equity and that the Federal

decisions control as to that over the decisions of the state court.

> "There is no recognized ground upon which equity can pursue a fund and impose upon it the character of a trust, except upon the theory *that the money is still the property of the plaintiff.* If he is permitted to follow it and recover it, it is because it is his own either in the form in which he parted with its possession or in a substituted form. We are unable to assent to the proposition that *because a trust fund has been used by an insolvent in the course of his business,* the general creditors of the estate are by that amount benefitted, and that therefore equitable consideration requires that the owner of the fund be paid out of the estate to their postponement or exclusion * * * and even if it is proved that the trust fund has been but recently disbursed and has been used to pay debts which otherwise would be claimed against the estate, there would be manifest inequity in requiring that the money so paid out should be refunded out of the assets, *for in so doing general creditors whose demands remain unpaid are in fact contributing to the payment of creditors whose demands have been extinguished by the trust fund.* Both the settled principles of equity and weight of authority sustain the view that the plaintiff's right to *establish a trust* and recover his fund

must depend upon his ability to prove that his property is in its original or a substituted form in the hands of the defendant." *Spokane County v. First National Bank*, 68 Fed. 979.

See also:

Zenor v. McFarlin, C. C. A. 238 Fed. 721.

A provision in the contract *In re Reynolds*, 203 Fed. 162, providing that the agent on the first day of each month should settle for the goods sold the previous month in cash or by his note, made the proceeds of the sale up to that time the property of the principal and *thereafter the property of the agent.*

The cases cited by cross-appellants (Page 74) are different in character from the instant cases. In the *International Agriculture Corp.*, *Bartling Tire Co.*, and *McGehee* cases there was involved only the simple proposition of certain specific accounts in the hands of the trustee in bankruptcy representing the sale of consigned merchandise. These accounts had not been discounted and the proceeds intermingled in bankrupt's business. In the *McGehee* case the court stated:

> "Where money had been received from the fertilizer and had gone into the general fund of McGehee, of course there would be no right on the part of the Troup Company."
>
> 166 Fed. 928, 929.

In the *Taft* case the funds were kept separate and apart from the general fund with the object in view

of enabling the consignor to trace the proceeds. 133 Fed. 511, 513, 514.

In re Kurtz (D. C. Penn.) was an action to compel bankrupt to pay over to the trustee certain funds.

Eiler's Music House v. Fairbanks, 80 Wash. 379, relied upon by claimants, stresses the necessity of tracing the funds. (See Page 75 cross-complainants' brief).

CONCLUSION

If the principal contracts are held not to be consignments, petitioners' entire case for reclamation fails. In such event a discussion on the cross appeal has no materiality.

The sale from Renfro-Wadenstein to Ketcham & Rothschild of furniture shipped prior to April 1, 1928, was consummated March 23, 1928. The contract was definitely accepted by Ketcham & Rothschild on March 23, again on March 30 and again April 2 and April 7. The bill of sale was not recorded until April 24. The sale was complete more than ten days prior to recordation, and was therefore invalid as to existing creditors. There was never any change in possession of the merchandise or anything to indicate to the outside world that there had been a transfer of title prior to recordation of bill of sale.

As to the Irwin contract, it was never recorded and there was no change in the possession of the merch-

andise and the contract was not finally completed until September 5, 1928.

These attempted transfers would in any event be preferences. The trustee stands in the position of an existing creditor; the dealer was insolvent at the time of the transfer; an insolvent corporation may not prefer its creditors; no present consideration was given for the conveyance. In fact a present obligation was incurred by dealer upon the consummation of the consignment contract which obligation imposed upon dealer the burden of being compelled to pay for the merchandise upon demand by manufacturer.

The accounts and proceeds whether considered in the light of the original contracts or in the operation of the parties thereunder did not constitute a trust fund but were at all times the property of Renfro-Wadenstein. This is apparent both from the action of the dealer and of the manufacturer. In any event there is no evidence to be found in the record tracing the fund in kind or in specific property into the hands of the trustee. Cross-appellants' brief makes no reference to such evidence.

We respectfully submit that these entire proceedings should be determined upon the basis that the principal contracts were not consignments but were in effect sales. We submit further that the decisions of the Referee and of the District Court on the subject matter of the cross appeal are fully sustained by

the evidence and the law and that the petitions for reclamation should be denied *in toto*.

Therefore, we respectfully request an order of this Court modifying paragraphs numbered 1, 2, 3 and 5 of the District Court's order, and denying reclamation *in toto*, and awarding the trustee his costs herein.

Respectfully submitted,

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